Supreme Court, U.S.
FILED
NOV 25 1996
CLERK

No. 96-584

In The

# Supreme Court of the United States

October Term, 1996

DOUGLAS R. PRINCE and
JANE PRINCE,

*Petitioners,*

v.

UNSECURED CREDITORS COMMITTEE,

*Respondent.*

**Petition For Writ Of Certiorari**
**To The United States Court Of Appeals**
**For The Seventh Circuit**

## PETITIONERS' REPLY BRIEF

RICHARD M. KATES
*Counsel of Record*
Suite 700
155 N. Michigan Avenue
Chicago, Illinois 60601
(312) 236-0267

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

6 pp

## PETITIONERS' REPLY BRIEF

Respondent's response in opposition unfortunately obfuscates that which is involved and is disingenuous.

This Petition involves that portion of a decision by the Seventh Circuit affirming a decision by the United States District Court dated April 10, 1991 (A25-40) *reversing* and remanding the Bankruptcy Court decision of September 15, 1989 (A41-50) which held the stock involved to be worth $7,500. That District Court decision as to the value of the stock directed:

> "The value of Prince's personal goodwill should be included". (A-39)

That was issue number 1 in the Court of Appeals. (A-6) No other District Court or Bankruptcy Court decisions are involved in this petition. The issue was in no way dependent on 11 U.S.C. §506(a) stated to be the statute involved in Respondent's reply. Respondent's attempt to frame the issue as going-concern value versus liquidation value was not what was involved in the decisions and issues below and is not herein involved.

The Seventh Circuit noted that the parties agree that if Dr. Prince's goodwill is excluded from the valuation calculus, the worth of the stock is limited to $7,500. (A-8) The experts of both parties agreed that the stock would not be worth more absent the professional corporation holding a covenant not to compete from Dr. Prince which it is agreed was not held. (A-4). Otherwise the stock would be worth $405,440 which is what a third party Dr. Clare offered to pay for the hard assets *plus* a 5 year covenant not to compete after certain nonconsequential deductions. (A-3, 6-7, 8). The Seventh Circuit adopted that later figure as the stock's value. (A-11). In so doing the Seventh Circuit had to attribute the good will as represented by the value of the covenant not to compete in Dr. Clare's post-bankruptcy contract as the value of Dr.

Prince's goodwill while he was with the corporation when it was in bankruptcy. In so doing, the Seventh Circuit stated:

> "On the other hand, Dr. Prince's goodwill, like the practice's physical equipment, can be sold and transferred, and once sold and transferred can generate value for another orthodontist. Although the mechanism of using his best efforts to transfer his patient's loyalties to Dr. Clare and then securing the transaction with a covenant not to compete is not as simple as signing over title to a physical asset, the functional effect is the same. Dr. Prince could sell and deliver his goodwill to Dr. Clare and Dr. Clare would then reap the value of the asset. Thus, Dr. Prince's goodwill is not intrinsically part of his human capital, but rather is a separate tangible capital asset of the practice, like a trademark would be." (A-17).

The language then refers to footnote 5 which states as follows:

> "Note that the mere fact that Dr. Prince's goodwill was created through years of his practicing in the community does not alter the conclusion that it is an asset separate from his human capital. If Dr. Prince were to have fashioned one of the practice's physical assets with his own hands, this would not change the fact that the asset could be sold and, therefore, that the asset had value independent of Dr. Prince. The earnings exception does not exclude earnings from an asset created by a debtor's past labors, only the earnings from actual services performed by the debtor in the *future.*" (A-17)

The Seventh Circuit concludes:

> "The value of Dr. Prince's goodwill represents future cash flows not from the earnings for future services actually performed by Dr. Prince,

> but from return on an intangible asset that could be sold and transferred with the sale of the practice."

Thus according to the Seventh Circuit, a professional's goodwill is like a piece of meat or a machine owned by a bankruptcy estate and subject to sale. The asset can be secured with a covenant not to compete.

Respondent says this is an issue pertaining only to Dr. Prince. It is obvious that this is an issue pertaining to every professional.

Respondent says that this is in accord with the Illinois Supreme Court in *In re Marriage of Zells*, 143 Ill. 2d 251, 572 N.E. 2d 946. (1991) That is untrue. The recent Illinois Supreme Court case of *In re the Marriage of Talty*, 166 Ill. 2d 232 at 238-40, 652 N.E. 2d 330 at 333-4 (1995) cites *Zells* as holding "goodwill represents merely the ability to acquire future income", and that that case involved a professional practice wherein goodwill is generally personal to the professional, and the case went on to make the following distinction: to the extent goodwill inheres in the business, existing independently of the individual's personal efforts, and will outlast his involvement with the enterprise, it should be considered as an asset of the business, and, in contrast, to the extent that goodwill of the business is personal to the individual, depends on his efforts and will cease when his involvement ends, it should not be considered property (it is income generating ability that goes with the person). In this case, the experts on both sides agreed that the stock was not worth anything over the $7,500 in physical assets absent a restrictive covenant with Dr. Prince. The reason was that Dr. Prince could leave his one-man professional corporation and open across the street and his patients would follow for it was he that they went to for treatment. And it is clear that Dr. Prince had no restrictive covenant. Thus under Illinois law the goodwill belonged

to Dr. Prince, personally. It was his personal ability to generate income. It was his human capital. Forcing a professional to purchase his own personal goodwill as being part of a corporation's stock value was taking away what the professional personally owned and charging the professional for his own income generating ability as being a corporate asset contrary to the holdings of the Illinois Supreme Court as well as the future earnings exemption of 11 U.S.C. §541(6). Just because personal goodwill can be transferable by transition services and covenants not to compete does not change its nature.

In this context, the petition referred to ownership of the covenant not to compete, meaning, as the cases and national text cited, the post-petition proceeds from such covenant. Respondent is correct that this case is not a fight over proceeds from a covenant not to compete and that the Seventh Circuit does not deal with such ownership. However, Judge Grady in the District court raised the subject because the sale of stock to Dr. Clare which the District court used as the benchmark for the value of Dr. Prince's goodwill was a sale of stock with a covenant not to compete and Judge Grady stated that a covenant not to compete would not be considered within the earnings exemption of 11 U.S.C. §541(6) for future earnings from services because such earnings were for nonservices. (A-35-36). That is the subject of the conflicts addressed in petitioners' petition which respondent states are not involved in this case. The Fourth Circuit cited the *Prince* District Court opinion in this case as support for its view which was that of Judge Grady in *In Re Andrews*, 80 F. 3d 906 at footnote 14 and the opposite conclusion is drawn by the 5th Circuit in *Matter of Walden*, 12 F. 3d 445 at footnote 12. The dispute involves various courts on both sides. However, petitioner does acknowledge that

such a dispute is merely tangential to the *Prince* case. It is addressed only by the District court.

The most serious issue is the treatment of the personal good will of a professional as separate from the professional and as an intangible asset of a corporation, an asset that asset subject to sale in bankruptcy, whereas it is a part of a debtor's future earning capacity. If a debtor chooses to sell part of that future earning capacity as a covenant not to compete, it is true that it can be severed, but is the debtor who has that right to sell a part of his future earning capacity and that does not alienate the debtor's goodwill from his earning capacity. Respondent's position that this is a non-issue because personal goodwill can be transferred does not warrant the conclusion that the petition for the writ should not be granted because that could lead, as here, to professionals having to purchase part of their future earning capacity, their personal goodwill, to use that earning capacity and to have part of their future earning capacity be subject to being part of the bankruptcy estate subject to sale to others which violates the future earnings exemption under 11 U.S.C. §541(6) and ignores Illinois law holding what is involved to be future earning capacity.

Dated: November 25, 1996

Respectfully submitted,

RICHARD M. KATES
*Counsel of Record*
*for Petitioners*
166 N. Michigan Ave,
Suite 700
155 N. Michigan Ave.
Chicago, IL 60601
312/236-0267